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Nos. 85-1219, 85-1236, 85-1237, 85-1250, and 85-1252

In the Supreme Court of the United States

OCTOBER TERM, 1985

Supreme Court, U.S.
FILED
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JOSEPH F. SPANIOL, JR.
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TRANSWESTERN PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ANR PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TEXAS EASTERN TRANSMISSION CORP., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TRUNKLINE GAS CO. AND
PANHANDLE EASTERN PIPE LINE CO., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ARKLA ENERGY RESOURCES, ETC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission reasonably exercised its statutory authority to regulate natural gas pipeline rates by adopting a rule requiring pipelines to eliminate from their tariffs "minimum bill" provisions that permit a pipeline to charge a customer for the variable costs associated with a specified volume of gas even if the customer does not actually take delivery of the gas from the pipeline.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A56) is reported at 770 F.2d 1144.[1] The orders of the Federal Energy Regulatory Commission (Pet. App. A71-A128, A129-A225, A226-A230, A231-A270, A271-A279) are reported at 27 F.E.R.C. ¶ 61,318; 28 F.E.R.C. ¶ 61,175; 29 F.E.R.C. ¶ 61,076; 29 F.E.R.C. ¶ 61,077; and 29 F.E.R.C. ¶ 61,332.

JURISDICTION

The judgment of the court of appeals (Pet. App. A57-A68) was entered on August 20, 1985, and petitions for rehearing were denied on October 25, 1985 (Pet. App. A69-A70). The petition for a writ of certiorari in No. 85-1219 was filed on January 21, 1986; the petitions in Nos. 85-1236 and 85-1237

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[1] "Pet. App." refers to the appendix to the petition in No. 85-1219.

were filed on January 22, 1986; and the petitions in Nos. 85-1250 and 85-1252 were filed on January 23, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Natural Gas Act, 15 U.S.C. 717 *et seq.*, empowers the Federal Energy Regulatory Commission to regulate the rates charged by natural gas pipelines for sales of natural gas. This case involves a rule promulgated by the Commission pursuant to this statutory authority; the Commission barred natural gas pipelines from using "minimum commodity bills" to charge their customers for the variable costs associated with a specified volume of gas whether or not the customer takes delivery of that much gas. The Commission also prohibited the use of similar tariff and contract provisions requiring a customer to take physical delivery of a specified amount of gas.

a. The rates charged by natural gas pipelines generally consist of two basic components. A "demand charge" is imposed upon all customers who are entitled by contract to receive a specified amount of natural gas from the pipeline. As the court of appeals explained, this charge "is not levied upon each unit of gas sold, but rather is a fixed sum, assessed in proportion to the maximum quantity of gas the customer is entitled to demand under the contract. The demand charge thus recoups some portion of the fixed costs incurred by the pipeline in providing a transmission mechanism of sufficient capacity to meet the customer's peak-load minimum entitlement." Pet. App. A19; see also *id.* at A71-A72.

The second component of pipelines' rates is the "commodity charge" levied upon each unit of gas sold. It is through this charge that a pipeline recovers its variable costs as well as the fixed costs that are not recovered through the demand charge. Pet. App. A18-A19; A72. Some pipelines include in their rate schedules a specific type of commodity charge known as a "minimum commodity bill." These minimum bill provisions essentially establish a minimum commodity charge, requiring the customer to pay for a certain quantity of gas even if the customer does not take delivery of any gas during the relevant time period. *Id.* at A19; A72-A73.

The Commission in the past has permitted pipelines to utilize minimum bill provisions because these provisions assist in the recovery of fixed costs. Minimum bill provisions typically are imposed upon a pipeline's "partial requirements" customers—those customers with access to more than one pipeline supplier.[2] Partial requirements customers can "swing from one source of supply to another." Pet. App. A75; see also *id.* at A19. If a partial requirements customer takes less gas from a pipeline than the pipeline expected to sell, and the pipeline is unable to sell the gas elsewhere, the revenue received by the pipeline pursuant to its commodity charge will be reduced and the pipeline may fail to recover its fixed costs.

Minimum bills guarantee a minimum payment by partial requirements customers; they provide protection against underrecovery of fixed costs and ensure that partial requirements customers bear an appropriate share of fixed costs. Minimum bills also pre-

[2] "Full requirements" or "captive" customers are those who purchase their entire natural gas supply from one pipeline. Pet. App. A75.

vent pipelines from incurring the "take or pay" costs that can result when the pipeline's contract with its supplier provides that the pipeline will take a particular amount of gas or pay for that amount of gas. If the pipeline's sales decrease, the pipeline may not take the required quantity of gas and may be forced to make "take or pay" payments to its supplier. Since minimum bills discourage partial requirements customers from shifting suppliers, they assist pipelines in avoiding take or pay costs. Pet. App. A19-A20.

If the pipeline does incur take or pay costs, these costs generally may be included in the pipeline's rate base; the take or pay costs are treated as an investment upon which the pipeline may earn its prescribed rate of return. The typical take or pay contract provision then allows a pipeline five years to take delivery of the gas for which it has prepaid. If the pipeline fails to take delivery of the gas within the required period, it can recover prudently incurred take or pay costs. Pet. App. A20-A21; A78.

It is significant that the justifications for minimum bills traditionally focused upon the recovery of pipelines' fixed costs. As the Commission observed, "[t]he recovery of *variable* costs via minimum commodity bills [was] simply not an issue in the past. This is because interstate pipelines generally were buying all the gas they were offered * * * and because the major variable cost—the gas supply itself —represented a far smaller proportion of the minimum commodity bill than it does today." Pet. App. A79 (footnote omitted; emphasis in original); see also *id.* at A21.

b. In August 1983, the Commission issued a Notice of Proposed Rulemaking stating that it proposed

to eliminate minimum bills from pipelines' tariffs to the extent these provisions permitted the recovery of variable costs. The notice solicited comments from interested parties regarding the Commission's proposal. Pet. App. A22, A73-A74.

After considering comments from more than 90 parties, the Commission concluded that "collection of variable costs via a pipeline's minimum bill tariff provision is unjust and unreasonable under the Natural Gas Act" (Pet. App. A74). It promulgated a rule declaring "inoperative and of no effect at law" existing rate schedules and tariffs that provide for "recovery of purchased gas costs for gas not taken by the buyer"; the rule also bars the filing of new rate schedules or tariffs providing for "recovery of variable costs associated with gas not taken by the buyer" (*id.* at A123). Pipelines remain free to continue to utilize minimum bill provisions to recover their fixed costs.[3]

The Commission found that minimum bills had "become a vehicle by which enormous purchased

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[3] The Commission subsequently extended this rule to cover "minimum take" provisions, under which the customer is required to take physical delivery of a minimum quantity of gas and does not have the option of paying for gas not taken (see Pet. App. A231-A268). It concluded that "minimum take provisions operate to prevent purchasers from pursuing a least-cost purchasing strategy, thereby resulting in charges to customers in excess of the lowest reasonable rate consistent with reliable, long-term supply" (*id.* at A235) and found that minimum take provisions "share fully the market-distorting influences of the variable costs in minimum commodity bills" (*id.* at A236). The Commission therefore found that the same rule should apply to minimum take provisions, noting that a pipeline remained free to "seek recovery of fixed costs incurred as a result of a customer's failure" to meet its purchasing obligations (*ibid.*).

gas 'costs' can be collected even if the pipeline never actually incurs such costs" (Pet. App. A81). It stated (*id.* at A82):

> By definition, there are no variable costs incurred for volumes not purchased for resale. Accordingly, a minimum commodity bill that includes variable costs gives a pipeline the right to collect for "costs" it has not in fact paid out to provide jurisdictional natural gas service. On its face then, a minimum bill that permits such "cost" collection is unjust and unreasonable.

The Commission noted that the amounts of variable "costs" collected pursuant to minimum bills had increased dramatically as a result of the deregulation of natural gas prices: "gas prices have risen to the point that purchased gas costs make up the majority of a pipeline's variable costs and hence its commodity rate" (*id.* at A81). The elimination of variable costs from minimum bill provisions would prevent pipelines from reaping this financial windfall.

The Commission further found that minimum bills permitting recovery of variable costs had the effect of restraining competition, with the result that gas prices were " 'propped up' * * * at levels higher than the market would otherwise support" (Pet. App. A86 (footnote omitted)). A pipeline's "partial requirements customers cannot purchase lower cost gas supplies if they are required to pay for the higher-cost gas they do not take" (*id.* at A85). Minimum bill provisions thus insulate pipelines from market pressures: "[w]hen distributors and pipelines are required to purchase gas under a minimum commodity bill, even when less expensive sources are available, the supplier pipeline can continue to oper-

ate profitably without having to worry about keeping its gas costs at a reasonable level" (*id.* at A86).

Moreover, the Commission found that including variable costs in minimum bills "deprive[s] producers of the opportunity to increase sales volumes in exchange for accepting a reduction in price" (Pet. App. A87). This is because "[a] pipeline cannot offer to buy more gas from a producer that lowers its prices if that pipeline's customers are under minimum commodity bill obligations elsewhere" (*ibid.*); the pipeline would not be able to dispose of the larger quantity of gas because it would not be able to increase its own sales.

The Commission concluded that these significant adverse effects of permitting recovery of variable costs through minimum bill provisions outweighed any possible benefits of allowing such cost recovery. It first observed that the justifications traditionally advanced in support of minimum bill provisions concerned the recovery of fixed costs. This function was important when pipelines were making large investments in new facilities, but the Commission noted that "most pipelines are not in this situation" (Pet. App. A90). Many pipelines now use a rate approach that "permits recovery of more fixed costs in the demand charge and diminishes much of the formerly perceived need for minimum commodity bills" (*ibid.*). Moreover, pipelines using more traditional rate approaches still would be permitted to recover fixed costs through minimum bills; the rule bars only the inclusion of variable costs.

The Commission rejected claims that its new rule would adversely affect customers who rely upon a single pipeline as their only source of natural gas. The Commission noted that "viewed from a national

perspective, the rule may create offsetting benefits and detriments to captive customers, depending upon whether they are served by a high-cost or a low-cost pipeline" (Pet. App. A96-A97 (footnote omitted)). And customers of a high-cost pipeline would be protected from unwarranted rate increases through the Commission's regulation of pipeline rates under the Natural Gas Act (*id.* at A97-A100).

Finally, the Commission determined that pipelines should not be permitted to recover take or pay costs through minimum bills.[4] The Commission observed that a pipeline customer's decision to reduce its take of gas below minimum bill levels would not necessarily force the pipeline to incur take or pay costs. In addition, revenues from minimum bill provisions previously had not been viewed as compensating pipelines for take or pay costs; rather, "existing minimum commodity bills seem designed to prevent take-or-pay prepayments from being incurred in the first instance, by discouraging consumer cutbacks. This effect is * * * anti-competitive, unjust, and unreasonable." Pet. App. A103-A104.

Even if a pipeline did incur increased take or pay costs, "it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later" (Pet. App. A104). Requiring customers subject to minimum bills to absorb a pipeline's take or pay costs also would be inequitable, the Commission found, because

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[4] As discussed above (see page 5, *supra*), take or pay costs are costs incurred by a pipeline pursuant to a provision in the contract between the pipeline and its supplier requiring the pipeline to take delivery of a specified quantity of gas from the supplier or pay for that quantity of gas.

"full requirements customers not subject to a minimum commodity bill may be as much responsible for take-or-pay payments as swing customers who are subject to a minimum commodity bill" (*id.* at A105). If the pipeline "is permitted to 'cover' its take-or-pay costs via minimum bill charges, the customers subject to a minimum commodity bill will bear a disproportionate burden of the pipeline's take-or-pay obligations" (*ibid.*).[5]

2. The court of appeals unanimously affirmed the Commission's decision in virtually all respects (Pet. App. A1-A56).[6]

The court first addressed the Commission's statutory authority to issue the rule barring recovery of variable costs through minimum bill provisions. It stated that Section 5 of the Natural Gas Act, 15 U.S.C. 717d, empowers the Commission to fix "just and reasonable" rates and found that this authority, combined with the Commission's general rulemaking power (see 15 U.S.C. 717o), justified the issuance of the rule (Pet. App. A24-A25). The court also rejected several challenges to the Commission's statutory authority. First, it found that the elimination of variable costs from minimum bill provisions did

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[5] The Commission observed that the allocation of take or pay costs among pipeline customers might present special considerations warranting the allocation of such costs in a manner different from the allocation of other costs. It directed the Commission staff to study this question and address the issue in individual pipeline rate proceedings. Pet. App. A105-A107.

[6] The court remanded for further consideration the Commission's decision that downstream pipelines cannot recover through minimum bills certain fixed costs that their pipeline suppliers may include in minimum bills. Pet. App. A46-A50.

not constitute an impermissible revocation of the conditions of the certificates of public convenience and necessity issued to pipelines under Section 7 of the Natural Gas Act, 15 U.S.C. 717f. The court noted that certification of a pipeline's initial terms of service does not constitute a guarantee that those terms will not be changed pursuant to the Commission's authority to regulate rates under Section 5 (Pet. App. A25 n.9). Moreover, the court held, "elimination of minimum bills has no effect on the pipeline's *authorized* service. The Order merely addressed the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5" (*ibid.* (emphasis in original)).

Second, the court rejected arguments that the rule impermissibly altered the terms of existing contracts, holding that "section 5 gives the Commission authority to alter terms of any existing contract found to be 'unjust' or 'unreasonable'" (Pet. App. A25-A26 n.9). Third, the court concluded that various settlement agreements in rate proceedings did not bar the Commission from adopting the rule; the court found that the rule did not conflict with the terms of the settlements (*id.* at A26-A29).[7]

On the merits, the court held that the Commission's decision to adopt the rule was supported by substantial evidence. The court identified (Pet. App. A33) "[t]hree essential findings" underlying the Commission's determination:

> First, minimum bills allow pipelines to recover for various costs that they do not incur. Second,

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[7] The court also held that the application of the rule to imported gas was not inconsistent with the Economic Regulatory Administration's authorization of the importation of that gas (Pet. App. A30-A31).

> minimum bills prevent gas purchasers from purchasing the lowest priced gas and hence artificially maintain high gas prices. Third, the benefit of eliminating variable cost recovery through minimum bills outweighs the negative impact such action will have upon pipelines and upon full requirements customers.

The court held that "the factual support for the overrecovery rationale is unassailable. Minimum bills allow [a] pipeline[] to charge for gas that its customer does not take; if the customer pays for gas not taken, the pipeline recovers for variable costs that it does not incur" (Pet. App. A33). The circumstance that a particular pipeline actually may not have overrecovered its costs did not undercut the Commission's conclusion, but "merely reflects the rational choice of its partial requirements customers to take gas that they must pay for rather than pay for gas not taken. The lynchpin [*sic*] of the Commission's rationale, however, is the *potential* for overrecovery" (*id.* at A33-A34 (emphasis in original)).

The court also upheld the Commission's determination that the record showed that minimum bills adversely affect competition. The court emphasized that the Commission's determination did not rest solely upon economic theory, observing that "[t]he record is replete with comments from customers who have been unable to purchase lower cost gas because of minimum bills and minimum take provisions" (Pet. App. A36 (footnote omitted)). The court concluded that "[e]ven if some customers do not pursue * * * [a least cost purchasing] strategy, the Commission has presented evidence that many customers will, and thus the elimination of minimum bills can reasonably be expected to lower gas costs and spur competition among pipelines" (*id.* at A37).

The court also upheld the Commission's determination that the benefits of eliminating variable costs from minimum bills outweighed any potential harms to pipelines and captive customers from that course of action. The court noted that "[t]he Commission gave considerable attention to the difficult take-or-pay issue" (Pet. App. A38). It agreed with the Commission that reductions in purchases by partial requirements customers would not necessarily result in take or pay liability and that pipelines could avoid take or pay costs by lowering prices to maintain sales. The court further noted that the increased price competition resulting from elimination of minimum bills "may spur renegotiation of take-or-pay clauses with gas producers" (*id.* at A39).

The court recognized "that many of the policy considerations that support the elimination of variable cost recovery for the minimum bill might support the elimination of take-or-pay clauses" (Pet. App. A39-A40), but it upheld the Commission's decision to take action only with respect to minimum bills. The court observed that the agency was not required to address all problems in a single rulemaking; rather, "[t]hat which we can require, the Commission has here provided: an explicit assessment of the relationship between the action taken and the issue deferred, and a reasonable conclusion that the public interest can best be advanced by the measured step taken" (*id.* at A40).

The court also determined that the Commission had adequately considered claims that pipelines' captive customers would bear increased costs if the pipelines lost sales (Pet. App. A41-A42). The court stated that "[h]ad the Commission either failed to address the problems faced by captive customers or

engaged in a less than candid balancing of the costs, its determinations perhaps would be vulnerable on review. The Commission, however, exhaustively considered these problems, recognized that some harm would result from the elimination of minimum bills, indicated it would consider in individual cases whether particular cost swings warrant special allotment of costs, and, finally, concluded that the benefit of increased competition would eventually inure to even the captive customer of a high-priced pipeline. These are the hard choices agencies are empowered—indeed required—to make" (*id.* at A41-A42).

Finally, the court affirmed the Commission's decision to address the minimum bill issue through a rulemaking proceeding rather than in pipeline-by-pipeline adjudications. It found that the "generalized nature of the problems addressed * * * did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking * * * was a manifestly reasonable method of addressing the systemic problems of the natural gas market" (Pet. App. A52) (footnote omitted)).[8]

ARGUMENT

The thorough opinion of the court below, upon which we rely, is correct and does not conflict with any decision of this Court or another court of appeals. Further review by this Court is not warranted.

1. Petitioners present two challenges to the Commission's statutory authority to issue a rule prohibiting recovery of variable costs through minimum bills. First, petitioners argue (85-1219 Pet. 10-11; 85-1237

[8] The court also upheld the Commission's decision granting an exemption from the rule to one pipeline company (Pet. App. A43-A46).

Pet. 8-10) that the rule destroys the mutuality of obligation between pipelines and their customers. The court of appeals properly characterized this claim as "frivolous" (Pet. App. A25 n.9).

Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), expressly provides that "[w]henever" the Commission finds that "any rate [or] charge" or "contract affecting such rate [or] charge" is "unjust, unreasonable, unduly discriminatory, or preferential," the Commission shall determine the "just and reasonable rate, charge, * * * or contract to be thereafter observed and in force, and shall fix the same by order." As this Court has recognized, Section 5 confers upon the Commission "plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." *Permian Basin Area Rate Cases*, 390 U.S. 747, 783-784 (1968); see also *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 646-647 (1972). In *Permian Basin*, the Court upheld an order issued by the Federal Power Commission that barred the use of escalation clauses in existing contracts; the order in this case invalidating another sort of unreasonable contract provision therefore plainly falls within the Commission's statutory authority.[9]

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[9] Petitioners' references (85-1219 Pet. 8-10) to the role of contracts under the Natural Gas Act are irrelevant. Contract provisions cannot remain in effect when they contain terms found by the Commission to be unlawful under Section 5.

Petitioners observe (85-1219 Pet. 13-14) that the minimum bill provisions were approved by the Commission in earlier proceedings. This Court in *Permian Basin Area Rate Cases, supra*, recognized that such prior administrative action was immaterial; it declined to set the Federal Power Commission's order aside "merely because the Commission ha[d] on an earlier occasion reached another result; administrative author-

Moreover, petitioners' argument is completely insupportable in the present context because petitioners have not been deprived of the principal benefit of minimum bill provisions. Pipelines are barred only from recovering variable costs (principally the cost of purchased gas), and a pipeline will not incur this cost if the customer chooses not to purchase the gas. Thus, the minimum bill provision still fulfills its purpose of assisting pipelines in recovering their fixed costs; pipelines simply cannot recover variable costs for gas that they do not sell.[10]

Second, petitioners assert (85-1219 Pet. 22-25; 85-1252 Pet. 8-14) that the Commission lacks authority to issue the rule because the rule alters the terms of certificates of public convenience and necessity previously issued by the Commission pursuant to Section 7 of the Natural Gas Act, 15 U.S.C. 717f. Section 7 provides that a natural gas company must obtain a certificate of public convenience and necessity before it begins operations; the circumstance that a minimum bill provision was one of the terms and conditions of a pipeline's original certificate is simply irrelevant here. As the court of appeals observed, "elimination of minimum bills has no effect on the pipeline's *authorized* service. The [Commission's] Order merely addresses the *rates* the pipeline may

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ities must be permitted, consistently with the obligations of due process, to adapt their rules and policies to the demands of changing circumstances" (390 U.S. at 784).

[10] Petitioners argue (85-1219 Pet. 21-22) that they will be unable to recover take or pay costs but, as we discuss below (see pages 19-20), it is not clear that the rule regarding minimum bills will result in the imposition of take or pay costs upon pipelines and, in any event, recovery of these costs traditionally has not been a purpose of minimum bills.

charge its customers and therefore was properly issued pursuant to Section 5" (Pet. App. A25 n.9 (emphasis in original)).

Once a certificate of public convenience and necessity authorizing pipeline service is issued by the Commission, the pipeline becomes subject to the Commission's authority to set "just and reasonable" rates. The Commission is free to utilize its Section 5 rate regulating authority to alter the rates contained in the original certificate. See *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. at 643, 646-647 (Commission may use its Section 5 authority to regulate rates to release pipelines from their obligation to deliver certificated quantities of gas "whether or not it could also invoke § 7 for that purpose"); *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 392 (1959); *Pacific Gas Transmission Co.* v. *FPC*, 536 F.2d 393, 395-397 (D.C. Cir.), cert. denied, 429 U.S. 999 (1976). The Commission otherwise would be powerless to adjust the rate terms set forth in the original certificate. Indeed, the Commission itself concluded that Section 5 "*require*[*s*] the Commission to change terms and conditions under which a pipeline renders a certificated service if those terms and conditions result in rates and charges which are subsequently found unjust and unreasonable" (Pet. App. A135 (emphasis in original)).[11]

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[11] Petitioner Arkla Energy Resources claims (85-1252 Pet. 10-12) that the Commission may not use its Section 5 authority to prohibit minimum take provisions. However, the Commission's Section 5 authority extends to all terms and conditions of service affecting rates and charges; minimum take provisions plainly fall within this category. See page 6 note 3, *supra*.

Petitioner ANR Pipeline Co. asserts (85-1236 Pet. 14-16) that the Commission exceeded its statutory authority in prom-

2. Most of the arguments advanced by petitioners relate to the propriety of the Commission's policy determination. The court of appeals' thorough analysis of these issues (Pet. App. A32-A50) conclusively demonstrates that substantial evidence supports the Commission's decision to bar recovery of variable costs through minimum bills. This Court has stated repeatedly that the courts of appeals bear principal responsibility for determining whether an agency's decision is supported by substantial evidence; this Court will intervene only when the court of appeals has "misapprehended or grossly misapplied" the standard of review. *American Textile Manufacturers Institute* v. *Donovan*, 452 U.S. 490, 523 (1981); *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 309-310 (1974). Petitioners do not even come close to showing that the court of appeals committed such an error here.

Petitioners do not dispute that recovery of variable costs through minimum bills results in a windfall to

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ulgating the rule because the rule abrogates a rate proceeding settlement agreement to which the Commission was a party. The court of appeals correctly concluded (Pet. App. A27-A29) that the rule did not abrogate the settlement agreement. The settlement agreement "merely defers resolution of the minimum bill issue" (*id.* at A29) and expressly states that "no party waives any rights with respect to the substantive standards for decision which should be applied herein" (85-1236 Pet. B1-B2). Thus, the settlement did not exclude the issue from the general rulemaking proceeding (Pet. App. A29).

Moreover, the Commission surely was correct in concluding (Pet. App. A110) that it may utilize its Section 5 rate regulating authority to alter a provision of a settlement agreement. Otherwise, the Commission could be bound forever by a settlement, regardless of how unjust or unreasonable the terms of the settlement had become.

a pipeline because the pipeline has not sold any gas and therefore has not incurred any variable costs. Several petitioners do assert that the Commission erred in concluding that the provisions are anticompetitive (85-1219 Pet. 18-20) or that the Commission should not have considered competition in its analysis (85-1237 Pet. 7; 85-1250 Pet. 10-15). But the Commission surely did not err in concluding that the effect of minimum bill provisions upon competition is a factor that may be considered in assessing the reasonableness of the provisions under Section 5. Congress itself has placed great emphasis upon encouraging reliance upon market forces in the natural gas industry. See *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board*, No. 84-1076 (Jan. 22, 1986), slip op. 11. And petitioners have not presented evidence contradicting the Commission's careful analysis of the competitive effect of these provisions. See Pet. App. A34-A37, A85-A92; see also pages 7-8, *supra*.

Petitioners' basic argument (85-1219 Pet. 21-22; 85-1236 Pet. 9-14; 85-1237 Pet. 14-15; 85-1250 Pet. 15-19) is that pipelines will be harmed financially by the Commission's rule because they will be required to bear take or pay costs. But the Commission and the court of appeals agreed that the elimination of variable costs from minimum bills would not necessarily result in the imposition of take or pay liability upon pipelines. The Commission summarized its conclusions as follows:

> [C]ustomer cutbacks below minimum bill levels may not cause *any* take-or-pay costs. Second, even if take-or-pay payments do result from such cutbacks, existing minimum commodity bills generaly [*sic*] do not serve to compensate for the

> cost of the take-or pay gas, and thus do not protect a pipeline's remaining customers from any resulting rate increases. Third, it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later.

Pet. App. A104 (emphasis in original); see also *id.* at A39.

Petitioners argue that the new rule will affect their "very viability as * * * continuing entit[ies]" (85-1250 Pet. 17) and that they have been placed in "a contractual vise" (85-1237 Pet. 14), but these assertions were for the Commission to evaluate. As the Commission and the court of appeals observed, pipelines might be able to sell the requisite quantity of gas by lowering prices, or they might be able to eliminate or reduce their take or pay obligations through renegotiation with gas producers. Pet. App. A39, A172, A182-A183. Moreover, a pipeline that does incur take or pay costs generally may include those costs in its rate base and, if necessary, can recover prudently incurred take or pay costs from its customers (see page 5, *supra*). Thus, a variety of methods are available to pipelines to ameliorate potential take or pay liability.[12]

3. Petitioners also contend (85-1219 Pet. 12-17; 85-1237 Pet. 10-13) that the Commission erred be-

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[12] Petitioners state in conclusory terms that the rule adopted by the Commission will increase costs for captive customers of pipelines (85-1236 Pet. 8, 10), but they present no evidence contradicting the Commission's conclusion that such customers will benefit in the long term from the elimination of variable costs from minimum bills and can be protected in the interim from improper rate increases (Pet. App. A95-A100).

cause it implemented its new policy regarding minimum bills by issuing a rule rather than undertaking individual pipeline-by-pipeline adjudications. These claims are without merit.

The Commission plainly has statutory authority to set rates and charges by rulemaking rather than adjudication. Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), states that the Commission may establish just and reasonable rates "after a hearing," but the provision has not been construed to require a formal evidentiary hearing in every case. *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 840-841 (5th Cir.), cert. dismissed, 439 U.S. 801 (1978); *American Public Gas Association* v. *FPC*, 567 F.2d 1016, 1064-1067 (D.C. Cir. 1977), cert. denied, 435 U.S. 907 (1978); *Phillips Petroleum Co.* v. *FPC*, 475 F.2d 842, 848-851 (10th Cir. 1973), cert. denied, 414 U.S. 1146 (1974); see also *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, 241 (1973) (statutory requirement of a hearing satisfied by written comments). Moreover, Section 403(c) of the Department of Energy Organization Act, 42 U.S.C. 7173(c), provides that "[a]ny function * * * which relates to the establishment of rates and charges under the * * * Natural Gas Act * * * may be conducted by rulemaking procedures." Since the present proceeding obviously relates to "rates and charges," Section 403(c) authorized the Commission to proceed by rulemaking.

Petitioners surely are incorrect in asserting (85-1219 Pet. 15-17) that because the Commission's ratemaking decisions are reviewed under the "substantial evidence" standard (see 15 U.S.C. 717r(b)), the Commission may only set rates through adjudicatory proceedings. The standard of review applicable to an administrative decision does not affect the proce-

dure that the agency must follow in reaching that decision. Pet. App. A54-A55; *American Public Gas Association* v. *FPC*, 567 F.2d at 1067; see also *United States* v. *Florida East Coast Ry., supra.* Indeed, a contrary conclusion would conflict directly with this Court's determination in *Vermont Yankee Nuclear Power Corporation* v. *NRDC*, 435 U.S. 519 (1978), that a court may not "overturn [a] rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the [Nuclear Regulatory] Commission so long as the Commission employed at least the statutory *minima*" (435 U.S. at 548).[13]

In view of the Commission's statutory authority to proceed by rulemaking, its decision to select that course of action plainly is not subject to challenge. See *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947) ("the choice made between proceeding by general rule or by individual ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency"). The court of appeals correctly concluded that "[t]he generalized nature of the problems addressed * * * did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking * * * was a manifestly reasonable method of addressing the sys-

[13] Petitioners contend that the rule set forth by this Court in *Vermont Yankee* is not applicable here because the present proceeding involves "fact-specific findings affecting a limited number of companies" (85-1219 Pet. 17). Petitioners' assertion is incorrect. The type of costs that may be recovered through minimum bills is a general issue affecting all natural gas pipelines that involves industry-wide questions; it therefore properly was addressed by the Commission through a rulemaking proceeding. See Pet. App. A52.

temic problems of the natural gas market" (Pet. App. A52 (footnote omitted)).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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